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ABSTRACT

This report, third in a series on education finance, examines U.S. education budgets recently passed by state legislatures and contrasts them with proposed gubernatorial budgets. The generally strong economy allowed state legislatures to increase total state FY 1998 education spending by over $2 billion (1.5 percent) from governors' own proposed budgets. Nine states increased their budgets by over 10 percent from FY 1997, and four states increased their budgets less than 3 percent. The major factors influencing education budgets were finance and tax system changes (toward greater state funding responsibility) and increasing enrollments. Court mandates in six states (Alabama, Arizona, New Jersey, Ohio, Vermont, and Wyoming) and threatened mandates in two others (Mississippi and Illinois) spurred legislators to alter their finance systems. Additionally, eight states enacted property tax changes, with New York, Texas, and Vermont the most far-reaching. Many changes involved mandated local property-tax reductions, with the state reimbursing local governments for lost revenue. With enrollment up over 1.4 percent nationally, legislatures had to accommodate the increased student population through hiring additional faculty, building new schools, and/or enhancing existing facilities. This year's state education budgets were 7.2 percent above last year's. Future budgetary influences will reflect court actions and the strength of the economy. (Contains 24 endnotes.) (MLH)

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# STATE FISCAL BRIEF

Center for the Study of the States
Nelson A. Rockefeller Institute of Government

October 1997
No. 44

ED 412 659

## *States' FY 1998 Education Budgets Increase 7.2%*

DAVID S. LIEBSCHUTZ, JEFFREY S. SCHIEDER & DONALD J. BOYD

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### HIGHLIGHTS

- State legislatures passed elementary and secondary school budgets for FY 1998 that will be 7.2% higher than FY 1997.
- With strong state fiscal conditions, these adopted budgets were 1.5% higher than what governors had originally proposed.
- Most of the increase from FY1997 is due to two factors: enrollment increases and movement in several states toward a greater state share of funding education.
- Vermont and New York made the largest changes in revenue sources for education, though several other states made modest changes.
- Enrollment is estimated to have increased about 1.4% nationally from September 1996 to September 1997, with the Far West (2.4%) and Southwest (2%) growing the most rapidly.

### INTRODUCTION

This is the third in a series of *State Fiscal Briefs* on education finance by the Center for the Study of the States. The first one, "Education Spending Faces Demographic and Other Pressures," (#38 – December 1996) gave an overview of spending trends since 1970 and discussed some of the major factors that have influenced education spending (e.g., special education, teacher salaries and equipment and other capital purchases). The second brief, "Governors' FY 1998 Education Budgets Focus on Property Tax Cuts and Enrollment Changes," (#43 – May 1997) discussed proposed state budgets for public elementary and secondary education for FY 1998, which began in most states on July 1, 1997, and described the proposed budgets and the major factors that influenced those proposals (e.g., the desire for property tax cuts and the need to address increasing enrollment).

This *State Fiscal Brief* examines the education budgets recently passed by the state legislatures and contrasts them with the proposed gubernatorial budgets. Future *State Fiscal Briefs* will examine the impact of court mandates and their effect on spending disparities between wealthy and poor school districts, and analyze how spending varies between districts and across states and has changed over time.

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## OVERVIEW

### *General Themes*

The generally strong economy across the United States during the past year allowed state legislatures to increase total state FY1998 spending on education by over $2 billion (1.5%) from what the governors proposed in their budgets. Nine states increased their budgets by over 10% from FY 1997, and four states increased their budgets less than three percent. The major factors influencing education budgets were:

1. **Finance and Tax System Changes** -- Court-imposed mandates in six states and the possibility of mandates in two others made legislatures make at least some changes in their finance systems. Alabama, Arizona, New Jersey, Ohio, Vermont, and Wyoming all made or are in the process of making major changes in the way they fund education, while Mississippi also made changes in order to avoid such court mandates. Illinois attempted, at least in part to preempt a court ruling, but failed to change its funding system. In addition, eight states enacted changes to their property tax with New York, Texas and Vermont, the most far-reaching. These changes most often took the form of mandated local property tax reductions, with the state reimbursing local governments for lost revenue.
2. **Enrollment** -- With enrollment up over 1.4% nationally, legislatures also had to deal with accommodating the increased student population through hiring additional faculty, and building new schools or enhancing existing schools.

## FINAL K-12 BUDGETS

### *Regional Trends*

As Table 1 and Figure 1 show, four of the eight U.S. Census regions have state K-12 spending growth rates at or above the national average of 7.2%. The Southwest grew the fastest with an 11.6% increase in expenditures for FY 1998, with the Plains growing at 8.7%, the Far West at 8.5%, and New England at 7.9%. The other four regions -- Mid-Atlantic (6.3%), Southeast (6.1%), Great Lakes (5.6%), and Rocky Mountain (3.2%) -- grew less than the national average, though it should be noted that all regions in the country grew at least as fast as the rate of inflation.

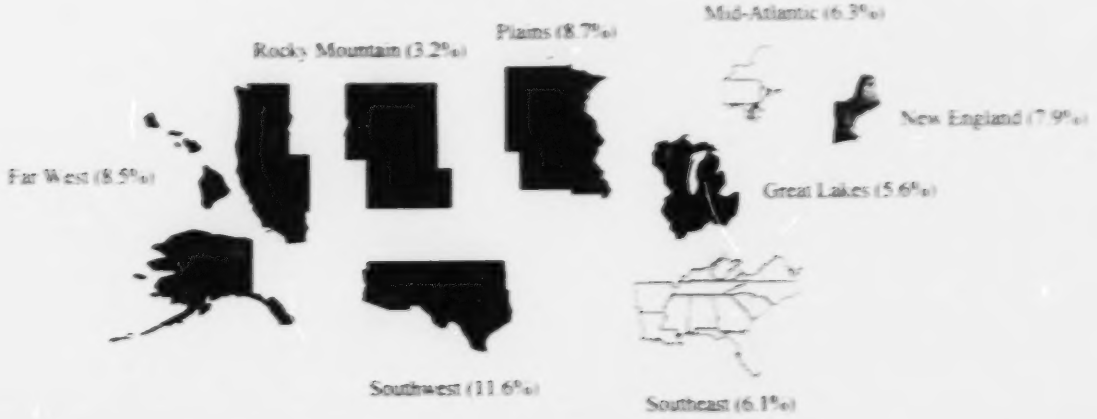
However, the Southwest's growth rate of nearly 12% is deceptively high as Texas, which accounts for about two-thirds of the total expenditures of the Southwest region, will grow by 14% because of the shift of $1 billion of education funding from local school districts to the state over the next two years. Arizona, which made court-mandated increases in its education spending program, will grow 11%, the other two states in the region -- New Mexico and Oklahoma -- will grow only about five percent on average.

Likewise, the Far West's growth rate of 8.5% is heavily influenced by California, which accounts for 71% of the region's total spending. California's expenditures will increase 8.4% between FY 1997 and FY 1998 as healthy growth in state personal income tax revenue and enrollment affect the amount of expenditures under the state's Proposition 98.* Most of the increased expenditures will go toward an expansion in Governor Pete Wilson's (R) Class Size Reduction program, special education reform, and a 2.65% "cost of living adjustment" in aid to school districts.* Projected expenditure growth in the rest of the region varies widely with Oregon and Nevada increasing 26% and 15%, respectively, and growth in Alaska, Hawaii and Washington averaging only about 3%.

### *Enrollment Trends*

Enrollment growth is a major reason for spending increases in the Far West, Southwest, and Southeast (see Table 2 and Figure 2).* The Far West has the highest projected enrollment growth (2.4%), a percentage point above the national average (1.4%), with the Southwest at 2.0% and the Southeast at 1.5%. The Rocky Mountain (1.4%), Mid-Atlantic (1.3%), and New England (1.2%) regions have projected growth rates at or near the national average of 1.4%, with the Great Lakes (0.6%) and Plains (0.3%) well below average.

**FIGURE 1**
**% CHANGE IN REGIONAL SPENDING**



## TABLE 1: K-12 STATE SPENDING GROWTH, FY 1997 TO FY 1998[1]

| | Governor Recommend | | | Legislative Approved | | | | |
|---|---|---|---|---|---|---|---|---|
| | FY1997 (est) | FY1998 | FY97-98 % Change | FY 1997 Actual (est) | FY 1998 | FY97-98 % Change | Rank FY97-98 % Change | FY 98 % Dif. fromGov. Rec. |
| **United States** | **134,487** | **142,801** | **6.2%** | **135,162** | **144,983** | **7.2%** | | **1.5%** |
| **New England** | **5,439** | **5,774** | **6.2** | **5,449** | **5,880** | **7.9** | | **1.8** |
| Connecticut | 1,506 | 1,534 | 1.9 | 1,507 | 1,563 | 3.7 | 37 | 1.9 |
| Maine | 717 | 740 | 3.3 | 717 | 747 | 4.3 | 33 | 0.9 |
| Massachusetts* | 2,428 | 2,676 | 10.2 | 2,438 | 2,706 | 11.0 | 9 | 1.1 |
| New Hampshire* | 93 | 114 | 22.5 | 93 | 124 | 33.2 | 1 | 8.8 |
| Rhode Island* | 490 | 503 | 2.6 | 490 | 519 | 5.9 | 25 | 3.2 |
| Vermont | 205 | 207 | 1.3 | 205 | 221 | 8.1 | 17 | 6.7 |
| **Mid-Atlantic** | **23,293** | **24,105** | **3.5** | **23,346** | **24,828** | **6.3** | | **3.0** |
| Delaware | 554 | 597 | 7.8 | 591 | 607 | 2.7 | 46 | 1.6 |
| Maryland | 2,448 | 2,581 | 5.4 | 2,448 | 2,605 | 6.4 | 21 | 0.9 |
| New Jersey | 4,851 | 5,038 | 3.9 | 4,851 | 5,315 | 9.6 | 11 | 5.5 |
| New York | 10,265 | 10,567 | 2.9 | 10,272 | 10,951 | 6.6 | 19 | 3.6 |
| Pennsylvania | 5,174 | 5,321 | 2.8 | 5,184 | 5,350 | 3.2 | 41 | 0.5 |
| **Great Lakes** | **24,333** | **25,590** | **5.2** | **24,376** | **25,733** | **5.6** | | **0.6** |
| Illinois | 4,174 | 4,404 | 5.5 | 4,165 | 4,508 | 8.2 | 15 | 2.4 |
| Indiana* | 2,863 | 2,951 | 3.0 | 2,863 | 3,097 | 8.2 | 16 | 5.0 |
| Michigan* | 8,483 | 9,027 | 6.4 | 8,535 | 8,820 | 3.3 | 40 | (2.3) |
| Ohio* | 5,205 | 5,445 | 4.6 | 5,205 | 5,538 | 6.4 | 22 | 1.7 |
| Wisconsin | 3,607 | 3,763 | 4.3 | 3,607 | 3,769 | 4.5 | 31 | 0.2 |
| **Plains** | **9,885** | **10,538** | **6.6** | **9,875** | **10,735** | **8.7** | | **1.9** |
| Iowa* | 1,650 | 1,721 | 4.3 | 1,651 | 1,721 | 4.2 | 34 | (0.0) |
| Kansas | 1,676 | 1,813 | 8.2 | 1,676 | 1,898 | 13.3 | 6 | 4.7 |
| Minnesota* | 2,989 | 3,212 | 7.5 | 2,989 | 3,332 | 11.5 | 7 | 3.8 |
| Missouri | 2,561 | 2,690 | 5.0 | 2,552 | 2,682 | 5.1 | 29 | (0.3) |
| Nebraska | 575 | 595 | 3.5 | 575 | 595 | 3.6 | 39 | 0.1 |
| North Dakota | 215 | 234 | 8.8 | 215 | 233 | 8.5 | 13 | (0.4) |
| South Dakota | 219 | 273 | 24.8 | 218 | 273 | 25.5 | 3 | 0.0 |
| **Southeast** | **30,875** | **32,536** | **5.4** | **31,066** | **32,962** | **6.1** | | **1.3** |
| Alabama* | 2,449 | 2,578 | 5.3 | 2,474 | 2,572 | 3.9 | 35 | (0.2) |
| Arkansas** | 1,260 | 1,330 | 5.6 | 1,260 | 1,370 | 8.7 | 12 | 3.0 |
| Florida | 6,632 | 7,008 | 5.7 | 6,632 | 7,063 | 6.5 | 20 | 0.8 |
| Georgia | 4,295 | 4,451 | 3.6 | 4,460 | 4,650 | 4.3 | 32 | 4.5 |
| Kentucky[2] | 2,433 | 2,509 | 3.2 | 2,432 | 2,509 | 3.1 | 44 | (0.0) |
| Louisiana | 1,975 | 2,037 | 3.2 | 1,975 | 2,098 | 6.2 | 23 | 3.0 |
| Mississippi | 1,098 | 1,129 | 2.8 | 1,098 | 1,162 | 5.9 | 26 | 3.0 |
| North Carolina | 4,310 | 4,711 | 9.3 | 4,310 | 4,724 | 9.6 | 10 | 0.3 |
| South Carolina | 1,376 | 1,435 | 4.3 | 1,376 | 1,442 | 4.8 | 30 | 0.5 |
| Tennessee | 2,154 | 2,327 | 8.0 | 2,154 | 2,323 | 7.8 | 18 | (0.2) |
| Virginia | 2,895 | 3,021 | 4.3 | 2,896 | 3,049 | 5.3 | 28 | 0.9 |
| West Virginia | NA | 904 | | NA | 902 | | NA | (0.2) |
| **Southwest** | **13,450** | **15,067** | **12.0** | **13,448** | **15,002** | **11.6** | | **(0.4)** |
| Arizona | 1,973 | 2,104 | 6.6 | 1,975 | 2,192 | 11.0 | 8 | 4.2 |
| New Mexico | 1,310 | 1,332 | 1.7 | 1,310 | 1,358 | 3.6 | 38 | 1.9 |
| Oklahoma | 1,534 | 1,615 | 5.3 | 1,534 | 1,626 | 6.0 | 24 | 0.7 |
| Texas | 8,634 | 10,017 | 16.0 | 8,629 | 9,826 | 13.9 | 5 | (1.9) |
| **Rocky Mountain** | **4,531** | **4,704** | **3.8** | **4,536** | **4,682** | **3.2** | | **(0.5)** |
| Colorado | 1,719 | 1,855 | 7.9 | 1,720 | 1,818 | 5.7 | 27 | (2.0) |
| Idaho | 699 | 715 | 2.2 | 689 | 715 | 3.8 | 36 | (0.0) |
| Montana* | 461 | 454 | (1.6) | 461 | 476 | 3.2 | 42 | 4.9 |
| Utah | 1,420 | 1,450 | 2.1 | 1,422 | 1,429 | 0.5 | 48 | (1.5) |
| Wyoming[3] | 231 | 231 | 0.0 | 244 | 244 | 0.0 | 49 | 5.6 |
| **Far West** | **26,289** | **28,250** | **7.5** | **26,674** | **28,930** | **8.5** | | **2.4** |
| Alaska | 687 | 702 | 2.2 | 687 | 697 | 1.5 | 47 | (0.7) |
| California*[4] | 18,501 | 19,915 | 7.6 | 18,909 | 20,495 | 8.4 | 14 | 2.9 |
| Hawaii | 676 | 700 | 3.6 | 676 | 696 | 3.0 | 45 | (0.6) |
| Nevada[5] | 536 | 630 | 17.5 | 537 | 620 | 15.4 | 4 | (1.7) |
| Oregon | 1,648 | 1,932 | 17.2 | 1,648 | 2,071 | 25.7 | 2 | 7.2 |
| Washington | 4,240 | 4,371 | 3.1 | 4,218 | 4,351 | 3.2 | 43 | (0.5) |

1. Unless otherwise noted, expenditure totals were provided by officials in state departments of education or budget agencies.
2. KY data for 1997 governor's recommended is not an estimated expenditure, it is what the governor recommended in his FY1997 budget.
3. Totals for FY97 and FY98 in WY were derived by dividing the FY96-98 biennium total for governor recommended and final legislative approved in half.
4. CA final FY1998 expenditure assumes $203 million in education funds vetoed by the governor is restored.
5. The NV governor's recommended and final legislatively approved totals for FY98 includes $51.4M and $43.9M, respectively, that can be used in either FY98 or FY99.

* Denotes that expenditure totals for this *Fiscal Brief* were derived using different sources than those used in *Fiscal Brief 43*, thus some totals may have changed.

** Numbers derived from *Education Week*.

**TABLE 2**
**PROJECTED K-12 ENROLLMENT GROWTH BY STATE, 1996 TO 1997[1]**

| | Actual Fall 1994 (000s) | Projected Fall 1996 (000s) | Projected Fall 1997 (000s) | % Change |
|---|---|---|---|---|
| **United States** | **44,030** | **45,615** | **46,269** | **1.4%** |
| **New England** | **2,055** | **2,137** | **2,163** | **1.2** |
| Connecticut | 507 | 532 | 537 | 0.9 |
| Maine | 213 | 215 | 214 | (0.5) |
| Massachusetts | 894 | 931 | 947 | 1.7 |
| New Hampshire | 189 | 198 | 201 | 1.5 |
| Rhode Island | 147 | 154 | 156 | 1.3 |
| Vermont | 105 | 107 | 108 | 0.9 |
| **Mid-Atlantic** | **6,604** | **6,854** | **6,942** | **1.3** |
| Delaware | 107 | 112 | 114 | 1.8 |
| Maryland | 791 | 827 | 840 | 1.6 |
| New Jersey | 1,174 | 1,226 | 1,248 | 1.8 |
| New York | 2,766 | 2,864 | 2,902 | 1.3 |
| Pennsylvania | 1,766 | 1,825 | 1,838 | 0.7 |
| **Great Lakes** | **7,175** | **7,317** | **7,362** | **0.6** |
| Illinois | 1,916 | 1,967 | 1,988 | 1.1 |
| Indiana | 969 | 982 | 989 | 0.7 |
| Michigan | 1,615 | 1,649 | 1,655 | 0.4 |
| Ohio | 1,814 | 1,834 | 1,840 | 0.3 |
| Wisconsin | 861 | 885 | 890 | 0.6 |
| **Plains** | **3,211** | **3,269** | **3,280** | **0.3** |
| Iowa | 500 | 503 | 501 | (0.4) |
| Kansas | 461 | 473 | 476 | 0.6 |
| Minnesota | 822 | 842 | 847 | 0.6 |
| Missouri | 879 | 896 | 902 | 0.7 |
| Nebraska | 287 | 290 | 290 | 0.0 |
| North Dakota | 119 | 118 | 117 | (0.8) |
| South Dakota | 143 | 147 | 147 | 0.0 |
| **Southeast** | **10,585** | **10,931** | **11,092** | **1.5** |
| Alabama | 736 | 742 | 748 | 0.8 |
| Arkansas | 448 | 456 | 458 | 0.4 |
| Florida | 2,109 | 2,247 | 2,300 | 2.4 |
| Georgia | 1,271 | 1,327 | 1,358 | 2.3 |
| Kentucky | 658 | 659 | 661 | 0.3 |
| Louisiana | 798 | 810 | 810 | 0.0 |
| Mississippi | 506 | 509 | 512 | 0.6 |
| North Carolina | 1,157 | 1,212 | 1,240 | 2.3 |
| South Carolina | 649 | 659 | 665 | 0.9 |
| Tennessee | 881 | 908 | 923 | 1.7 |
| Virginia | 1,061 | 1,097 | 1,115 | 1.6 |
| West Virginia | 311 | 305 | 302 | (1.0) |
| **Southwest** | **5,351** | **5,591** | **5,705** | **2.0** |
| Arizona | 737 | 803 | 832 | 3.6 |
| New Mexico | 327 | 346 | 352 | 1.7 |
| Oklahoma | 610 | 619 | 621 | 0.3 |
| Texas | 3,677 | 3,823 | 3,900 | 2.0 |
| **Rocky Mountain** | **1,620** | **1,673** | **1,696** | **1.4** |
| Colorado | 641 | 670 | 684 | 2.1 |
| Idaho | 240 | 251 | 255 | 1.6 |
| Montana | 164 | 168 | 169 | 0.6 |
| Utah | 475 | 484 | 488 | 0.8 |
| Wyoming | 100 | 100 | 100 | 0.0 |
| **Far West** | **7,429** | **7,843** | **8,029** | **2.4** |
| Alaska | 127 | 132 | 133 | 0.8 |
| California | 5,407 | 5,713 | 5,860 | 2.6 |
| Hawaii | 184 | 199 | 204 | 2.5 |
| Nevada | 251 | 282 | 295 | 4.6 |
| Oregon | 522 | 538 | 544 | 1.1 |
| Washington | 938 | 979 | 993 | 1.4 |

1 Projected K-12 enrollment numbers from US Department of Education, National Center for Education Statistics. *Projections of Education Statistics to 2007.* (June 1997) Table 45.

**FIGURE 2**
**FALL 1996-97 % CHANGE IN K-12 ENROLLMENT**

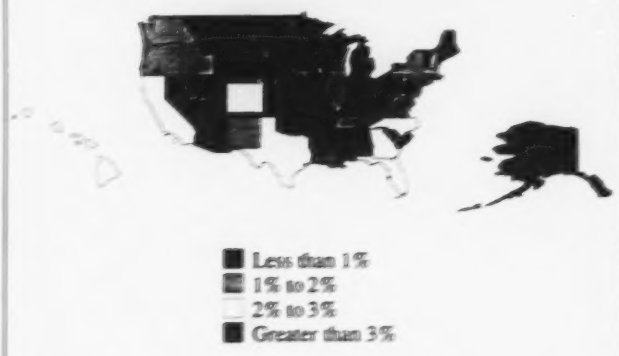
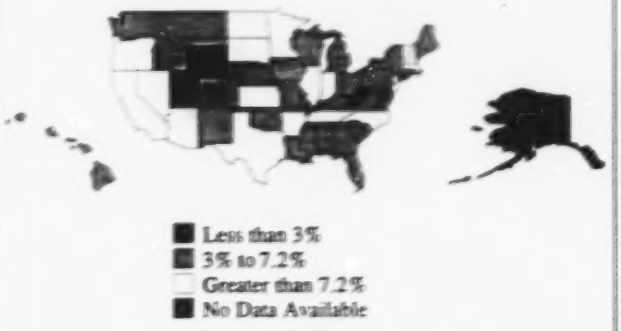



**FIGURE 3**
**% CHANGE IN STATE SPENDING, 1996-97 TO 1997-98**




## *Individual State Budgets*

**States Growing Above 10%**

As with the governors' proposed budgets, the driving forces behind the enacted budgets in the states with education budgets growing by more than 10% varied widely. Five of the states had some sort of property tax or other funding system change, while others had funding increases due to many other factors such as enrollment, court mandates, or new programs.

**New Hampshire** led the country with an increase in spending from FY 1997 to FY 1998 of over a third, but this increase is a bit misleading for several reasons. First and foremost, New Hampshire's state government appropriates the least of any state for K-12 education -- only $124 million for FY 1998 -- as it relies more on local property taxes for funding education than any other state (localities in New Hampshire accounted for 86% of K-12 funds in FY 1994 compared to the national average of 45%).[7] The large increase in funding results from Governor Jeanne Shaheen's (D) proposal to provide incentives to encourage

New Hampshire public schools are the only ones in the country not required to provide kindergarten. The legislature and the governor agreed to a compromise to increase kindergarten per-student funding from $500 to $750 and for the state to pay 75% (a total of $22.5 million) of class-size reduction construction costs. The governor had originally proposed to double state aid for kindergarten to $1,000 per-student and to provide $30 million in state bonds over the next five years for construction costs.

**Oregon**'s 26% growth results from replacing the expected lost local property tax revenues from the enactment of Measure 47 as well as compensating for enrollment growth and inflation. Measure 47, which passed in November 1996, amended the Oregon Constitution to limit 1997-98 property taxes to the lesser of 90% of the 1995-96 tax, or 100% of the 1994-95 tax, and it limits future annual property tax increases to three percent, with exceptions.[8] However, due to difficulties in implementing Measure 47, legislators put Measure 50 on a referendum ballot as a replacement for Measure 47. Passed in May, Measure 50 reduces and caps assessed values (whereas Measure 47 reduced and capped taxes) and will cost the state over $800 million over the FY1997-99 biennium as it is required to replace school property tax revenue districts will lose (but not revenues lost by non-school localities) from the implementation of Measure 50.

**South Dakota's** school funding will grow over 25% in FY 1998. This will be the second straight year of strong growth (in FY 1997, expenditures grew 26%), as the state phases in a new education finance formula that reduces the prior system's built-in incentive to districts to increase spending. The finance system has changed from an expenditure reimbursement to a guaranteed, per-student formula, which in FY 1998 will be $3,440. The state will calculate each district's property tax revenue contribution toward this per-student amount and will make up the difference. Prior to the change, in South Dakota, as in New Hampshire, localities provided a majority of school funding (60% in FY 1994).[9] After the formula change, localities will still provide a majority of school aid, financing about 50% of K-12 funds. The state share of K-12 funds will increase from 26% (in FY1994) to 38% (in FY1998), with the federal government supplying the rest.[10]

The 15% growth rate in **Nevada**'s spending is driven by the highest expected enrollment growth in the nation (4.6%), a 3% salary increase for all education staff, a 2% increase in school employee salary steps, and increases to the state's class size reduction and technology programs.

The 14% growth rate in **Texas** is caused by three factors: (1) increased state spending to reimburse school districts for lost property tax revenue due to a $10,000 increase in the homestead exemption (see below for a further discussion of the homestead exemption increase and the other property tax changes); (2) increased state spending for enrollment increases, technology, textbooks, and school facilities; and (3) the fact that the spending is "front-loaded" under the state's biennial budgeting system (in the second year of the budget, expenditures are projected to decline by 0.2%).[11]

**Kansas**'s 13% growth rate results from the reduction of the state-mandated local property tax mill levy from 33 mills to 29 mills in FY 1998 and to 25 mills in FY 1999. The reduction in local property tax revenues from the reduced mill levy will be made up by the state (see page 6 for further discussion).

**Minnesota**'s education budget will grow by over 11% for FY 1998 and 15% for the 1997-99 biennium. Increases in per-student formula aid ($76 for FY1998 and an additional $79 for FY1999) and enrollment growth aid account for the state's education budget growth.

**Arizona** and **Massachusetts** would both increase their education budgets by 11% in FY 1998. In Arizona, the increase comes from the state's response to a court mandate, a new Permanent State Common School Fund that will be used for both basic education programs and school facility needs, and the second highest projected enrollment growth in the country (3.6%). In Massachusetts, the increase comes from a continued commitment to the state's Education Reform Act. Passed in 1993, the Education Reform Act responded to a state supreme court ruling that the previous state education finance system was unconstitutional. Since its enactment in 1993, state funding for K-12 education has increased over $1 billion, a 71% increase.

## Difference between Gubernatorial and Legislative Budgets

Nearly every state legislature made some adjustments to the education budget proposed by its governor. In fact, only four state legislatures (Idaho, Iowa, South Dakota, and Kentucky) left the funding levels the same as proposed by the governor. Much of the reason for the average 1.5% difference between the gubernatorial and legislative budgets was due to better-than-expected tax collections between the time the budget was introduced (January or February in most states) and it was passed by the legislature (April to June). In most states, the strong economy allowed legislators to increase the amount dedicated to schools, although weak economic conditions in Alaska and Hawaii actually caused cuts in the final education budgets. In addition, court decisions in New Jersey, Ohio, Vermont, and Wyoming also forced legislatures to increase education budgets to better equalize funding between school districts.

## Funding System Changes

### *Property and Other Tax-Related Changes*

As we described in *State Fiscal Brief #43*, several property tax relief plans were proposed in FY 1997-98 governors' budgets. The proposals differed from state to state, but by and large most focused on school taxes and on taxes paid by homeowners. Some states would have required local governments to cap or reduce their property taxes, or to provide homestead exemptions, and would finance the local revenue loss with increased state aid. Other states would provide direct relief to taxpayers in the form of rebates or credits. Other states proposed cuts in their statewide property taxes (see Table 3 for summary).

## TABLE 3
## MAJOR PROPERTY TAX CHANGES

| State | Original Proposal | Final Action |
|---|---|---|
| **Kansas** | Lower state-imposed school property tax rate from 33 mills to 29 mills in FY98 and to 25 mills in FY99 ($41M for FY98) | Lowered the school property tax rate from 33 to 27 mills for school years 97-98 and 98-99; exempted first $20,000 of assessed value ($94M for FY98) |
| **Nebraska** | Various proposals were made to deal with effects of property tax levy caps placed on local governments (passed last year and in effect in 1998) | Rewrites formula used to calculate state aid to school districts; allocates extra $20M to localities for lost property tax revenue due to levy caps passed last year |
| **New York** | $3.4B in combined property tax relief for homeowners ($1.7B) and school aid ($1.7B) by FY 2001-02 | $2.3B in property tax relief in the form of state financed exemptions to school property taxes when fully phased in in FY2002 ($0 in FY1998) |
| **Oregon** | $423M (for FY1997-99 biennium) in additional state funds to replace property tax revenue school districts will lose due to Measure 47's implementation | Will allocate approximately $800M in additional state aid for schools in the FY1997-99 biennium to replace lost school property tax revenue caused by the implementation of Measure 50 |
| **Texas** | $2.8B in property tax relief (FY1998-99 biennium) by increasing the homestead exemption from $5,000 to $25,000; tax relief to be funded through a new business tax, a .5 % increase in the sales tax, existing budget surplus and leaner state government | $1B in property tax relief (FY1998-99) by increasing the homestead exemption from $5,000 to $15,000; lost revenue to school districts to be replaced by $1B budget surplus |
| **Vermont** | Various proposals were made until a compromise plan was decided upon | New statewide property tax of $1.10 per $1,000 of assessed value; $58M in other new state taxes; some local option taxes are allowed |
| **Washington** | $217M (FY1997-99) in property tax relief targeted for homeowners | Extended 4.7% cut in state property taxes; referendum to further cut property taxes is on November ballot |

By the end of the legislative sessions, seven states had passed major changes in their property tax systems: Kansas, Nebraska, New York, Oregon, Texas, Vermont, and Washington. The remainder of this section describes these property tax relief changes, beginning with the most sweeping.

Though **Vermont** has one of the smallest education budgets in the country, it enacted one of the most sweeping funding system changes, the "Equal Educational Opportunity Act of 1997." Otherwise known as Act 60, it was necessitated by a February supreme court decision striking down the prior funding system,[12] which was largely locally based,[13] instituted a statewide property tax of $1.10 per $1,000 of assessed value and increased many other pre-existing state taxes. School districts are given the authority to levy an equalized local property tax if they pass an education budget in excess of the general state grant. A local option property tax is also allowed for local districts. All revenues for education will be put into a separate state-administered education fund, which will provide approximately $5,000 per-student[14] in the form of a block grant as well as separate funding for programs such as special education and transportation. Local school districts will still be largely responsible for running their school systems; however, there will be additional responsibilities for meeting new state educational standards and developing new action plans and annual reports. The governor and legislature hope that all of these changes will withstand court challenge in the future.

**New York** Governor George Pataki's (R) proposed budget contained a five-year, $3.4 billion property tax relief program entitled, "STAR" (School TAx Relief). The program, when fully implemented, would have cut property taxes $1.7 billion by establishing a state-financed, homestead exemption program, under which the state would make up lost revenue to school districts, and would have provided an additional $1.7 billion in state aid for school districts.15 The program also would have given districts incentives to

freeze property taxes and reduce administrative costs. In response to the governor's proposal, the leadership of the State Assembly Democrats devised their own property tax reduction plan which would have increased the state's share of public education costs, made pre-kindergarten available to every four year old in the state, extended kindergarten to a full-day throughout the state, and reduced K-3 class sizes to no more than 20 students per class. After many weeks of debate, the legislature and the governor agreed to a four-year $2.3 billion state-financed, homestead exemption program that is essentially just the first piece of the governor's proposal and would essentially replace local tax revenues with state dollars. The K-3 class size reduction, pre-K availability for four year olds, and full day kindergarten programs championed by Assembly Democrats will be phased in beginning in FY 1998-99.

**Texas** Governor George Bush's (R) proposal for $3.6 billion of school property tax relief was set aside by the legislature in early March, while they considered alternatives. Bush's plan, the "Property Tax Cut Plan of 1997," proposed to submit before voters a constitutional amendment that would have increased the homestead exemption from school property taxes from $5,000 to $25,000, exempted business inventories from school property taxes, and uniformly reduced school tax rates by 20 mills. To pay for this property tax relief, Governor Bush would have dedicated $1 billion for property tax relief from an existing state budget surplus, instituted a new broad-based, flat rate 1.25% business tax (the Texas Business Tax) to replace the corporate franchise tax, increased the sales tax by half a percentage point to 6.75%, and assumed additional savings from "program efficiencies." Bush's proposal would have increased the state's share of public K-12 education costs to 60%, up from 40% in FY 1994.[16] After much debate in the Texas House and Senate over the scope of any change in the property tax structure, they finally passed a proposed constitutional amendment to increase the homestead exemption to $15,000, resulting in lost local revenues of $1 billion that would be made up for from state funds.[17] The amendment passed overwhelmingly (94% to 6%) on August 9. However, despite the increased state aid as a replacement for the homestead exemption, localities are actually raising their property tax rates.[18] The state share of K-12 funding is thus only estimated to increase from about 47% in FY1997 to 49% in FY1999 due to the state mandated property tax relief.

**Washington** Governor Gary Locke (D) proposed $217 million in property tax relief over the 1997-99 biennium, which would affect all local jurisdictions, not just school districts. The tax relief targeted homeowners through a state-imposed property tax credit, a property tax "smoothing mechanism,"[19] and a restriction placed on local regular property tax levies. Governor Locke has already signed into law a measure that extends a 4.7% cut in state property taxes into 1997 and will put a ballot measure -- Measure 47 -- before voters in November to make the cut permanent. In contrast to most other states' property tax cuts, Washington's tax cut program will decrease *state* property taxes, not local taxes. This has no direct effect on local tax revenue, but by relieving pressure on the property tax base, it might make it easier for school districts to fund education.

In **Kansas**, Governor Bill Graves (R) recommended decreasing the state-imposed local school finance levy from 33 mills to 29 mills in FY 1998 and to 25 mills in FY 1999. The Governor's recommended reduction in local tax effort would have totaled $41 million in FY 1998 and $89 million in FY 1999. However, subsequent to introducing his plan, the governor and legislature developed a compromise property tax plan that the Governor signed into law. It reduces the uniform school property tax levy from 33 to 27 mills for the 1997-98 and 1998-99 school years and removes the first $20,000 of assessed valuation of all residential property. This compromise property tax reduction plan will decrease local tax effort and increase state funding of the school finance formula by $94 million in FY 1998 and $139 million in FY 1999.[20]

**Oregon** Governor John Kitzhaber (D) recommended $423 million to cover expected school district revenue losses from the passage of Measure 47 in 1996. Measure 47 was expected to reduce 1997-98 local property taxes and limit future growth, albeit by a much smaller margin than did Measure 5 (passed in 1990). The state share of K-12 education funding was 27% before Measure 5 and 66% afterward. The state share of funding for education was expected to increase to 70% after Measure 47.[21] However, due to its vague language and questionable legality, the legislature ceased efforts to implement Measure 47.[22] Instead, Oregon lawmakers placed a new measure -- Measure 50 -- before voters on a May 20 ballot, which passed with 56% of the vote. This measure would do two things: (1) set a fixed, permanent tax rate for local school districts; and (2) reduce assessed value to 1995-96 levels minus 10% and cap growth at 3% a year (not to exceed fair market value).

In **Nebraska**, the legislature and Governor Ben Nelson (D) agreed on a new school finance formula, to be put into place for the 1998-99 school year, that will increase the state's share of education funding from approximately 40% to 50%. Contained in this legislation is $110M in additional state aid and $20M in replacement funding for local governments affected by levy caps passed last year which capped local property taxes at $1.10 per $100 of assessed value starting July 1, 1998 and at $1 per $100 in 2000.[23]

## COURT MANDATES[24]

In addition to the court-imposed changes in **Vermont** discussed above, several other states also responded to or are in the process of responding to actual or possible court decisions (see Table 4 for summary).

In January, the **Alabama** Supreme Court turned back a challenge to a 1993 state circuit court decision that declared the state's school finance system unconstitutional. The court gave the legislature a year to devise a constitutionally acceptable finance system, citing that if the legislature fails to do so, the court may adopt a solution of its own. Despite the fact that the state provides approximately 65% of total K-12 education, one of the highest rates in the

## TABLE 4

## RECENT SCHOOL FINANCE LITIGATION: FINANCING SYSTEMS DECLARED UNCONSTITUTIONAL

| STATE | DECISION DATE | STATE ACTION TO COMPLY |
|---|---|---|
| Massachusetts | June 1993 | Legislature passed the Education Reform Act in 1993 which increased the per student foundation aid level and has subsequently increased state aid over $1B over 5 years. |
| New Jersey | July 1994, May 1997 | In response to July 1994 decision, Governor Whitman proposed to tie school funding levels to statewide curriculum standards. In May, the state supreme court found the finance system, as it applies to 28 special needs districts, inadequate. The state allocated $246M in additional funds to these districts for the 1997-98 school year. The state must also study and develop programs that adequately address the special needs of these districts. |
| Arizona | July 1994, Nov 1996 | Legislature's plan to reform capital fund declared unconstitutional in Nov 1996; deadline of 6/30/98 for creation of acceptable system; Governor Symington signed capital finance bill in March 1997 that funnels sales tax revenue to poor districts. In August, a superior court judge declared that the new legislation did not satisfy court mandate. |
| Wyoming | Nov 1995 | Legislation creating a new finance system (based on a "education basket") passed by legislature and partially vetoed by the governor. A district court judge allowed the old finance system to be used for this school year. Thus the state has another year to work on a new finance system. |
| Alabama | Jan 1997 | Legislature has been given a year to remedy the system. No action has yet been taken. |
| Vermont | Feb 1997 | Passed legislation that will shift primary responsibility of funding education from localities to the state. Instituted new state property tax at $1.10 per $1,000 of assessed value and will raise $58M in new state taxes. |
| Ohio | March 1997 | Governor Voinovich has stated that the decision will most likely result in a tax increase for Ohio residents. No action has yet been taken. |
| West Virginia | April 1997 | Updating a 1982 state supreme court decision that found the state's school finance system unconstitutional, a specially appointed judge gave the state until March 16,1998, to present an acceptable plan. |

country, Alabama has one of the lowest total spending levels in the nation. This is due to low local contributions to K-12 due to low property wealth throughout the state and local governments' reluctance to raise property taxes. During a special session in late August-early September, the governor and legislature compromised on an education budget that will increase K-12 state spending 4% in FY1988 but does nothing to address school funding reform.

In March, then **Arizona** Governor Fife Symington (R) signed a capital finance plan that would give $32.5 million annually in sales tax revenue to low property wealth school districts. The plan, Assistance to Build Classrooms (ABC), was designed in response to a 1994 state supreme court decision declaring the state's school capital finance system unconstitutional due to facility construction and maintenance inequity among districts. However, in August, a county superior court judge declared the ABC plan inadequate in meeting the court mandated requirement to guarantee equal educational opportunities for Arizona students. The state supreme court will review the superior court judge's decision. If the supreme court upholds the decision, new Governor Jane Dee Hull (R) and the legislature will have until June 30, 1998 to develop an acceptable capital finance plan. If a new plan is not in place by then, the courts have the power to freeze all state aid to public schools.

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For the past two legislative sessions, **Illinois** Governor Jim Edgar (R) has failed to push through legislation that

would have reformed the state's school finance system. This year, a $1.5 billion reform plan to increase the personal income tax from 3% to 3.75% to pay for $900 million in property tax relief and $600 million in increased state aid for schools was killed by Senate Republicans. The governor has stated that he will again push for school finance reform next year, but considering that he will not run for re-election, any major finance reform seems unlikely. Though it was not in response to a court case and was not stated as a reason for the reform, the proposed finance reform in Illinois may be seen, at least in part, as a preemptive measure to avoid a court mandate to reform.

This year, **Mississippi** voluntarily adopted a new funding mechanism in part to avoid the possibility of a future court case. During the five-year phase-in of the Mississippi Adequate Education Program, the state will increase funding (up to $130 million in 2002) for capital construction. In 2003, the new funding formula based on student-based costs to achieve and maintain a level III (adequate) accreditation will replace the current formula based on teacher units.

In response to a 1990 state supreme court decision that declared the state's finance system unconstitutional, **New Jersey** Governor Christine Todd Whitman (R) signed the Comprehensive Educational Improvement and Financing Act of 1996 that created a new school finance system designed to tie school funding levels to statewide curriculum standards. In May 1997 the state supreme court declared the new finance system, as it applied to 28 special needs districts, unconstitutional, stating that the finance model used to determine base per-student costs did not adequately address the unique educational needs of the students attending the special needs districts. The court ordered the state to equalize state spending between the 28 poorest school districts and the richest 120 districts for the upcoming school year. The court also ordered the Commissioner of Education to assure that the new monies were spent "effectively, efficiently, and in the furtherance of the achievement of the core curriculum content standards." It also ordered the state to develop supplemental needs programs that address the special needs of the 28 "Abbott districts." In response to the court order, Governor Whitman allocated an additional $246 million in state aid for the "Abbott school districts" in July.

In March 1997, the **Ohio** Supreme Court declared the state's school finance system unconstitutional as it violated the "thorough and efficient" clause of the state's constitution. The court gave lawmakers one year to reform the funding system. Both Governor George Voinovich (R) and the legislature decided to pass the state's biennial budget in May without any major actions addressing the court decision. The governor's proposal for a one cent sales tax increase to fund school finance reform failed to garner any support in the legislature over the summer.

In April, a specially appointed judge updated a 1982 **West Virginia** Supreme Court ruling that declared the state's school finance system unconstitutional as it violated the state's constitutional "thorough and efficient" clause. The court gave the state a year to develop an equalized finance system. If an acceptable plan is not developed by March 16, 1998 the court has the option of appointing a "special master" to oversee the implementation of the education reforms required by the 1982 court decision.

In 1995, the **Wyoming** supreme court declared the state's school finance system unconstitutional and ordered the legislature to define a basic education ("the education basket"), determine the costs of providing that "basket," and design an equitable finance system to fund those costs. The court gave the legislature until July 1, 1997, to have a system in place. In response to the court mandated deadline, the legislature approved a new finance plan in April, but Governor Jim Geringer (R) vetoed the provision that would have allowed localities the option of levying limited taxes to supplement the state aid they receive. With the new finance system under threat of an injunction, a state district court judge ruled that the prior finance system could be used for the 1988-99 school year, giving the state another year to finalize a plan.

## Conclusions

This year's (FY98) state education budgets were 7.2% above last years' budgets. The major factors behind this increase were increased enrollment due to the "baby boomlet" and state efforts to assume a greater share of funding education. States increased their shares of education funding either in response to court decisions or as a way to fund local property tax relief.

There will be two main factors influencing education budgets in the next few years: actual or probable court decisions and the strength of the economy. With respect to the former, several states, such as the nine states listed above, as well as possibly a few others, may need to address court mandates that may fundamentally alter the way that they finance their public schools, such as happened in Vermont this year. With respect to the economy, state revenues continue to grow at a strong pace allowing state budgets to accommodate increases in education spending for growing enrollment and programmatic changes (such as New Hampshire's kindergarten initiative or California's class size reduction program). However, if there is a significant decline in state revenue growth due to a national or regional recession, it will force states and localities to make some hard choices about how they will fund education in the future.

Two other factors, capital funding and shifting responsibilities from local school districts to the state, may also play a large role in state education budgets in the next few years. The continued "baby boomlet," the desire for the latest technology and smaller class sizes, and aging facilities, combined with hostile public attitudes toward raising local taxes or borrowing for capital spending, will bring capital funding issues to the forefront of state education debates. In addition, there is a trend toward overall greater state responsibility for funding K-12 education driven by state court decisions declaring state education finance systems unconstitutional that rely too heavily on local property tax revenue as well as state efforts to reduce local property tax burdens.

## TECHNICAL NOTES

This report is based on information collected from Governors' FY 1998 proposed budgets, publicly released budget documents and discussions with state fiscal and education analysts. Other sources of information used in this report are: *Education Week*, *State Tax Notes*, and BNA's *Daily Tax Report*.

Education appropriation amounts are the Center's best estimates of actual state funds allocated for the purpose of educating students in public elementary and secondary schools. This definition includes state appropriations for: foundation aid, state categorical grants, special education services, administration, transportation, and school lunch programs. It excludes: federal funds, local property tax funds, and state funds used for adult education, pre-K programs, vocational education, and work force preparation. Education expenditures from Lottery Funds were included in state aid totals. Most appropriation totals are derived from a state's General Fund but some states, such as Massachusetts, Michigan, and Utah, have established separate school aid funds from which they fund K-12 education. These funds were then used to derive appropriation totals instead of the General Fund.

State appropriation amounts are not the same as total funds guaranteed to school districts by the state. The state guarantee is a target amount set by the state, usually in terms of a per-student guarantee, that is guaranteed to school districts. It assumes a combination of state and local money for funding districts. The state share of this guarantee will vary, by district, depending on the amount of revenues generated by localities, which are mainly revenues from property taxes. Thus, the state's share of funding in a school district in a wealthy district may be 30%, whereas the state's share in a poor district may be 50%. Wherever a state has established a state guarantee, the state share, not the "state guarantee," was used.

Twenty states have a biennial budget system. Thus, single-year appropriation totals may not be totally representative of the "bigger education funding picture" as, for accounting purposes, the state may front or back-load funding. Year-to-year analysis may misrepresent the bigger picture.

## ABOUT THE AUTHORS AND THE CENTER FOR THE STUDY OF THE STATES

Donald J. Boyd is the director of the Center. David S. Liebschutz is the associate director of the Center. Jeffrey S. Schieder is a research assistant at the Center. The Center is part of the Nelson A. Rockefeller Institute of Government, the public policy research arm of the State University of New York. Established in May 1990, the Center is a leading authority on developments in state finances and programs. Research for this report was funded by a grant from the Ford Foundation. The Center is located at 411 State Street, Albany, New York 12203-1003, phone (518) 443-5285, fax (518) 443-5274, e-mail: santosr@rockinst.org. For further information on this or other Center reports, contact the Center's administrative assistant, Rosann Santos.

## ENDNOTES

1. This report is based on information gathered from budget officials and public sources such as *Education Week*. As of the date of this report, we received information from all states but Wisconsin.
2. Unless noted otherwise, the budget figures in this brief are taken directly from documents provided by the states (e.g., state budgets or education department documents).
3. The Consumer Price Index grew at about 3% from June 1996 to June 1997.
4. Proposition 98 establishes a minimum funding level for K-12 under one of three formulas. Each of these formulas takes into account: general fund revenue, overall state and K-12 population, personal income, and local property tax collections into their calculations. Proposition 98 guarantees K-12 schools (and community college) annual funding equal to the greater of (1) a specified percent of the state's General Fund revenues or (2) the prior year's allocation adjusted for growth in students and inflation.
5. This adjustment allows districts to increase spending to keep up with the rate of inflation.
6. The discussion that follows is based on state-by-state enrollment projections contained in US Department of Education, National Center for Education Statistics. *Projections of Education Statistics to 2007* (March 1997) Table 45. These projections may vary significantly from states' own unpublished projections and should be viewed only as indicators of broad trends rather than as actual growth rates.
7. US Department of Education, National Center for Education Statistics. *Digest of Education Statistics 1996*. (November 1996) Table 156.
8. David S. Liebschutz, *State Fiscal Brief: 1996 State Tax and Budget Ballot Measures*. (Albany, NY; Center for the Study of the States, December 1996).
9. *Digest of Education Statistics 1996*. Table 156.
10. According to the most recent NCES data, federal funds made up 10% and private funds made up 3% of South Dakota's K-12 revenue for 1994-95. These percentages are not expected to change much under the new finance formula.
11. In the second year of the FY1996-97 biennium, state expenditures for K-12 decreased 3.9%, from $8,936 million in FY1996 to $8,634 million.
12. In Brigham v. Vermont, the Vermont Supreme Court declared the funding system unconstitutional, as it "deprive[d] Vermont children of an equal educational opportunity in violation of the Vermont state constitution." The court found wide funding disparities between school districts within the state, caused by the use of the local property tax as the main source of school revenues (where the value of taxable property varied widely among districts). The court also found that these substantial funding differences significantly affected opportunities to learn.
13. 62% of total revenues in FY 1994 came from local sources, *Digest of Education Statistics 1996*. Table 156.
14. To be adjusted annually for inflation.
15. The $1.7 billion is equivalent to about a 16% increase over five years.
16. *Digest of Education Statistics 1996*, Table 156
17. The constitutional amendment would also allow those over 65 to have their property taxes frozen even if they move.
18. Information provided by the Division of Budget and Planning, Office of the Governor.
19. "Smoothing mechanism" refers to the averaging of large changes in property valuation over a number of years. This helps to reduce the sudden and unexpected impact of a step-increase in property taxes. In Washington State, the state constitution would be amended to allow for large increases in property values to be averaged over a four year period.
20. *State Tax Notes*, Vol. 12, No. 13, March 31, 1997 and Vol. 12, No. 14, April 7, 1997.
21. Information provided by the Oregon Department of Administrative Services.
22. *State Tax Notes*, Vol. 12, No. 17, April 28, 1997.
23. According to Nebraska officials, this legislation will cost local governments about lose $200M in 1998.
24. This section is based on information listed on the Education Commission of the States' website (http://www.ecs.org/ecs/24ba.htm).

CENTER FOR THE STUDY OF THE STATES
The Nelson A. Rockefeller Institute of Government
State University of New York
411 State Street
Albany, New York 12203-1003

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